

A Historical and Current Perspective of Philippine Economic Problems

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FOREWORD

Immediately after the Philippine economy plunged into a deep balance of payments crisis in 1983, a good number of analyses were offered by experts on the reasons that led to the crisis. Few, however, offered as perceptive an analysis as Dr. Gerardo P. Sicat, former Minister of Economic Planning and Director-General of the National Economic and Development Authority, did during an address he delivered before the 21st Annual Meeting of the Philippine Economic Society (PES) in December 1984.

While Dr. Sicat's speech was sufficiently covered by the business media and included as part of the printed proceedings of the Philippine Economic Society in the first quarter 1985 issue of the *Philippine Economic Journal*, it is believed that this piece rightly deserves to be published as a "solo" document and included in the mainstream of Philippine economic literature. Hence, almost one-and-a-half years after it was first delivered, Dr. Sicat's address is being reprinted under the PIDS Monograph Series. The piece remains today as timely and significant as when it was first heard and read.

We hope that many of the insights and recommendations included in this piece will not be overlooked in the new agenda for our national economic recovery program.

FILOLOGO PANTE, JR.
President

ABSTRACT

The article analyzes the problems confronting the Philippine economy and offers an explanation of the reasons and events that led to the current economic crisis in the Philippines. After the author makes the necessary discounts for national political events and the role played by the international economy and other external factors, he focuses on the role played by the market mechanism in the history of the Philippine economy.

Much of the problems, according to the author, resulted from a cumulation of situations in which interventions in the market system made the economy less efficient. Deviations from the price mechanism as the prime element of solving essentially market problems aggravated national problems rather than lessened them. The author contends that the most glaring of these deviations was the unrealistic exchange rate policy adopted by government through the years. Consequently, with the worsening of some problems, the ability of the government to cope with other more basic duties was adversely affected.

Sicat cites two major components for recovery in the future: (a) restoration of credit lines and foreign exchange inflows through the sheer economics of readjustment; and (b) restoration of confidence in the Philippine economy. The latter is not only economic; it is essentially governed by political factors.

A HISTORICAL AND CURRENT PERSPECTIVE OF PHILIPPINE ECONOMIC PROBLEMS

*Gerardo P. Sicat**

Introduction

I am glad to be with the Philippine Economic Society especially at this 21st annual meeting when the principal topic is the Updated Philippine Development Plan. The Development Plan, always an exciting subject of discussion, is a document of potentially great significance to the nation's future.

I know not only from experience but also from conviction *before, during, and after* service in government that the Development Plan is hardly finished after the draft document had gone through the process of debate, approval, and printing.

The prepared document is only the framework utilized by government. It is used to attain, with limited resources, the country's economic aspirations. What the government and its instrumentalities do with the spirit and content of the plan signifies the real meaning of the implementation process. It also reveals the political will of the nation, as expressed by its leaders, in relation to its concept of planning.

Since the advent of the economic crisis, there has been a surfeit of explanations about what went wrong with the economy. It is fair game for every one to contribute his own analysis. For, if one has been hurt by an event or a condition, there must be some explana-

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tion which can be derived, either by introspection or from personal experience, for instance, from a logical study of the Philippine experience. In fact, the field of expertise responding to this question of *Why the crisis?* has enlarged somewhat by a geometric factor. Expert opinions, whether solicited or not, whether of the street or the desktop variety, are now too many. Sometimes, though, it is not necessarily true that good explanation drives out the bad. Some spurious explanations gain currency because, through laziness and lack of rigor, they are easier to understand. Hence, if the hypotheses explaining our malaise have multiplied, it is not necessarily the case that we have attained wisdom thereby.

One school of thought, not uncommon in some business, political, and other disgruntled sectors, follows the strain that the fault lies in "subservience of the government to policies dictated from outside." The diatribe about the evils of policies of external institutions and their being against Philippine interests then follows. The premise is therefore the conclusion, no matter how much embellished the matter is. Articulate laymen, including businessmen, lawyers, and engineers, as well as members of the so-called parliament of the streets, have echoed this reasoning.

This simplistic view is the equivalent of the argument, often stated unabashedly by government apologists, that the problems of the present crisis are the result of external economic forces beyond the control of policymakers and government. Naturally, a sensible, more independent-minded person would have to reject both explanations.

It is easy to find a scapegoat. But even this does not do away with the problem. It only leads to wrong conclusions and, therefore, to wrong policy recommendations.

There are of course some studies that have become reference points. Of these, the Task Force report of some professors at the School of Economics at the University of the Philippines has become a major document. This is a well-deserved status. The thoroughness of its coverage and the depth of the effort at quantifying its claims has opened some interesting propositions that would in the future be debated. Some of the claims it makes are undoubtedly controversial. This work has done the service of highlighting some of the important issues. This is why this document has become a definitive point of attack by those who detect different ghosts as lurking behind the economic crisis.

I have essentially kept quiet during this period. The only time I

was drawn out was when, at the invitation of the Society, I was asked to be a discussant of the task force analysis emanating from the School of Economics. Of course, not being the principal, I commented only on aspects of it.

Today, I think it my duty to offer an analysis of the problems confronting us. To begin with, this is as good a time as any for me to speak as freely as I can from a personal viewpoint. In order to flush out the problems, I will take a critical view. Probably, it is the kind of role that is expected of me. When I joined government, there were many things that did not satisfy me. When I left it, I had a feeling that something was partly accomplished but that there were serious drawbacks. So I left government feeling just as dissatisfied as when I came. I think this is a healthy attitude. Or else, one could become an unbearable apologist. Many of my former close co-workers in government will recognize the views and comments to be made shortly. So, one can at least say that I am true to my views.

Originally, I had wanted to give a more exhaustive historical insight into our present economic problems. After giving that a little try, it appeared that to give that topic the justice it deserves would need another occasion. It is therefore more appropriate to cite instances of recent history wherein the policies were not set correctly or when departure from superior policies was made.

This presentation allows us to put in perspective the reasons for the draconian economic policy restraints now being imposed to restore economic adjustment or recovery. It shows why the medicine is much more bitter than it would have been at much earlier periods when the measures appeared most sensible to take and why, predictably, one also cannot expect much progress in the next three to five years even if we are atoning now for the "sins of the past."

Indeed, the next few years will be very difficult years for the economy. No one should be deluded into thinking that the IMF loan and the restructuring of the external debt with the country's creditor banks and countries will give any quick order of recovery in the future. There are essentially two components: one is the hard business of restoring credit lines and foreign exchange inflows through the sheer economics of readjustment.

The other relates to the "confidence game." This is not only economic. In today's context and tomorrow's (meaning, the next few years), it is essentially governed by political factors. Any news and pictures about large demonstrations in Manila and NPA encounters in the South shake up the confidence of some decision-

makers about our foreign credits. Any speculation about the president's health calls to mind the present uncertainty, until 1987 at least, of the succession game.

At such times, the telephone wires keep burning and it would seem at least that PLDT is making good international business. It is a fact of life in our nation today that political confidence comes as an important issue. It displaces even the essential economic issues that we would have to squarely face later. Basically, therefore, we are facing new realities, and our political institutions are under test.

Let me begin first to assign a weight to a political event that has affected our country enormously last year. The assassination of Senator Aquino has done an enormous damage of setting back a large part of the timetable of development in the nation. This event alone scored neatly in undermining the credibility before the world of the present government, whether deserved or not. It took away the confidence that was already shaky at that point and made it a large event of consequential dimensions, thus aggravating a crisis that was already rearing its head.

As long as appropriate discounts for political events are made, we might as well also assign the due weight to the role played by the international economy, to new protectionism from industrial countries, to the oil shocks, and to international economic recession. All these factors influenced the constriction of Philippine economic options and, as a consequence, performance. But, as the many have asked, how come some countries, including at least one in the ASEAN region, have performed relatively well? They faced relatively the same influences and they also had suffered as much from the oil shocks.

Philippine Economic Malaise

The present economic crisis is a manifestation of the seriousness of the Philippine economic malaise. What is this malaise? The cumulation of economic and other factors that contributed to the crisis is like a convergence of the many tributaries and streams into a mighty river. A review of a common trait that can be traced to economic factors will show that, in many instances, the problems that arise are the result of a cumulation of situations in which interventions in the market system made the economy less efficient. Deviations from the price mechanism as the prime element of solving essentially market problems have aggravated national problems rather than lessened

them. With the worsening of some problems, the ability of the government to cope with other more basic duties was also affected adversely.

In one sense, the resulting situation deviated from the actual direction of promotion of free private enterprise. The existence of too many regulations and controls has distorted an essentially private enterprise economic system with too many hindrances to private initiative by impeding the exercise of initiative.

Economic crises have not been an uncommon phenomenon since independence. These crises were often signaled by large balance of payments deficits. The balance of payments position served as a gauge of the health of the economy. It reflected on the nature of domestic economic balance vis-a-vis the international picture. The influences operating on an open economy would somehow eventually give way if pressures were continually exerted on prices or on imports.

Persistent balance of payments deficits indicated that, somewhere in the economy, imports kept exceeding the earnings from exports, and that insufficient voluntary capital inflows could be found to finance these deficits. A chronic problem existed when these deficits occur recurrently. Therefore the analysis of the malaise must first take a look at those factors that have caused the persistent deficits.

Now, any sensible economist (or doctor) would recognize that the symptom is only a clue to the possible disease. There are other more important reasons. Like any good mechanic trying to analyze the reasons why a car fails to optimize performance on the basis of the manufacturer's claims, it would be essential to look at those factors that are responsible for the economy's below par performance. As in many things, one could look at this problem from any particular angle.

A Keynesian schooled in the absorption approach would look into the levels of aggregate spending and determine how much of that aggregate spending should be curtailed to restore economic balance. To some extent, this is the model that has underlied IMF-dominated adjustment policies which many developing countries criticize. By their nature, these measures are short-term and quite cutting in their impact on the economy.

A structuralist would look for the real factors that lurk behind the balance of payments deficits. This would require an analysis of the internal structure of the economy, pinpointing certain structural

difficulties which make economic progress difficult. Structural problems of the economy require a long-term adjustment solution. By and large, the World Bank has of late been associated with the structuralist school of thought.

Someone who believes in the "dependency" theory would look into the power relations between countries, especially between rich and poor countries. This viewpoint is much in vogue especially among non-economists who find the explanations of economic theory sometimes too abstruse. In fact, however, much of the dependency theory is devoid of economic theory; it derives its strength from historical and psychological relations of power. This probably explains the ease with which others, notably non-economists and those whose training in economics is only on the fringe, absorb this explanation quickly. It is an easy explanation like that describing imperialist-dependent country relations.

It is possible to weave oneself into any of these theoretical constructs and explain the Philippine economic malaise from their respective viewpoint. But avoiding all these, there is a much simpler route which has the most powerful explanation for the cumulation of problems that the economy has encountered. This is the rôle of the market mechanism.

The market mechanism can play a most constructive role in relieving government and policymakers of cumbersome problems. Many allocation problems get solved in an impersonal way. Provided efforts are made to see to it that a competitive solution is being arrived at, many of the intractable problems of economic development can be solved. Very often, the distrust of the so-called market solution is not really a distrust but a feeling born out of ignorance. Some policymakers are afraid that the market solution is the one made by monopolists using their monopoly power over powerless people. If monopoly is the problem, the market solution should promote conditions of greater competition. Sometimes, however, the greater mistake is to attempt to dismantle an otherwise competitive setup, installing a public monopoly which, in turn, becomes the source of market oppression and scarcities. In a market setup in which competitive forces are in operation, as any economist knows, excessive profits are erased, and more goods become available in the market at relatively cheaper prices.

The message of the market was lost along the way in the development economics of the last 40 years because of the alleged excessive preoccupation with "planning." Yet, as W. Arthur Lewis and other

distinguished economists would remind us, there could be planning with the help of the market. The market simplifies large problems. In fact, the message of the market, as a prime allocator, is found in the success stories of many countries in the Asian region. These countries are led by Japan and now by the so-called NICs or newly industrializing countries of South Korea, Taiwan, Hong Kong and Singapore.

In the Philippine case, there have been times when shifts toward better pricing policies occurred. Over time, decision-makers reverted to policies that contrived situations out of a competitive market policy setting. There is a persistent tendency to postpone market-liberalizing decisions. As will be illustrated shortly, there have been policy directions away from market-directed solutions. The prolonged clinging to price controls and the introduction of regulations which increased monopoly power of some state and private enterprises reduced the role of the market mechanism and introduced monopolies in the Philippine setting.

If the policies were more market-directed, the economy would have been able to realize the virtues of encouraging ventures in agriculture and in industry which would have been more labor-using. This certainly would have encouraged a surge of exports based on comparative advantage during the first and second decade of our independence. As we all know, by the end of that first decade of independence, capital and entrepreneurship in the country was already steeply entrenched in industries that were supposedly replacing imports by consuming, instead of adding to, our scarce foreign exchange resources.

When Milton Friedman visited Singapore in 1980, he lectured on the role of free enterprise and the price mechanism in some countries, including Singapore, as a major factor responsible for their rapid development. Whereupon the Singaporean economists and public officials pounced upon Friedman for his ignorance of the fact that Singapore's government plays a very strong role in the country's development policy, as, for instance, in the promotion of forced saving through the central provident fund and the housing program. In this exchange, it seemed that what was lost was the flavor of the role of Singapore's economic policy in promoting competitive enterprise, which is the basic ingredient of the strong role of private enterprise in that economy. In essence, Singapore's distinctive policy with respect to private enterprise is to encourage it by action and by inducements. Allowing competition and granting no special favors

are principal policies that the government has kept consistently.

Popular analysis of economic success stories of these countries often cite cultural and political factors in addition to special circumstances as dominant explanations. When they run out of argument in a comparative discussion with the Philippine case, they advance the level of economic or industrial development as being different, thus elevating the matter to a *reductio ad absurdum*. Not too long ago, these countries were not unlike in any of the initial conditions of development. When the economic factors are emphasized, the role of government (especially in the case of Japan, Korea, and Taiwan) as being supportive of industries through protection is mentioned. Yet, in the Philippines, government protection of industry has been one of the most outstanding features of industrial policy promotion. The professional consensus on this for the last twenty years has been that protection in fact was too much and needed reform at its very core.

A major reason for the strong competitive challenge emanating from these countries is to be found in their reliance on market forces whenever there are economic adjustments to be made. For instance, government procurement in Japan is a very competitive endeavor. In industrial promotion, domestic competition is a major market phenomenon. So is the competition for export markets, once relative guidance through MITI is determined. In all these, market forces are allowed to work more fully in encouraging an environment of competition. This is one reason why the rate of private bankruptcies in Japan is high even during times of prosperity.

By the same token, Korea adjusted exchange rates of its currency freely as often as necessary, whenever the international value of the *won* fell out of line with what was considered its competitive value in relation to export industries. Theirs is an exchange rate policy designed to price their exports cheaply and, in effect, competitively. This automatically adjusted import prices also by making them, through the exchange rate, expensive. Their enterprises face uniformly competitive pressures in their domestic and international operations.

Probing the Philippine Economic Malaise

It is useful now to deal more concretely with the Philippine case. Induced by demand in the U.S. market, the Philippines rapidly expanded during the colonial period. That period produced an unbalanced development which was closely linked to the fortunes of the

U.S. business cycle. Towards the end of American rule in our country, the economy was highly geared towards exports.

The country needed to diversify its economic structure. This included diversifying industries that earned export revenues. It was a major task of economic policy to develop a framework that would establish the relationship with the U.S. economy on a healthy and more diverse footing. This meant diversifying exports to other products in addition to, but not in place of, the major primary exports which already had an entrenched market.

The principal cue was missed. The trade adjustment program from 1946 to 1974 which included preferential trade with the U.S. was seen by some policymakers not as an advantage but as one that promoted a relationship of economic dependence upon the U.S. market. It was a setup that favored the continuation of primary export dependence. So, they decided that there was a need to develop industries that weaned the economy from the preferential framework as soon as possible. The preferential trade agreement was seen largely as a U.S. imperialist design to continue the trade domination of the country. But whatever may have been the imperialist designs of a former ruler, the country had enough options to take care of new directions for the future.

The special preferential tariff patterns favored imports from the Philippines into the American market. The grand opportunity to explore new export possibilities presented itself. This would have meant developing an industrialization strategy based on comparative advantage. But the opposite was undertaken. The government, through the policies of exchange and import controls and protection, decided to promote import replacing industries instead. This shortsightedness produced the contrary effect.

The experience of the East Asian NICs (newly industrializing countries) presented itself as a possible pattern that should have been followed. That would have been somewhat more painless in the case of the Philippines. The mechanism for it was available — the so-called Bell Trade Agreement and later, the Laurel-Langley Agreement which revised the former. This was uniquely a Philippine advantage. Other countries had no such preferential market to work with, except later in the 1960s and 1970s through the Generalized System of Preferences (GSP) of the UNCTAD which, compared to the Philippine preferential trade with the U.S., was a fairly limited form of concession from which the country also benefited.

The Philippine opportunity was unprecedented. The preferential

trade agreement was with the most prosperous, openly trading, and largest single economic market. Instead of taking advantage of this opportunity, Philippine policymakers saw ghosts of the dependent relationships that were unequal and perceived incorrectly the possibilities offered by the opportunities. Have we ever heard any voice today which does not blame unequal relations with the U.S. as a cause, partly, of our underdevelopment? In my view, those who nourished the policies of controls and import substituting industrialization of the past still decry this pattern.

After independence, a series of grand policy mistakes followed. These could only be attributed to erroneous perceptions of our economic problems. Consequently, the years whittled away resources and natural advantages that were in our hands. Many of our countrymen who tend to blame outside forces for our economic problems should attempt to review this phase of our economic history and the arguments put forward to protect the policy choices in those days.

What we tried to do in the early 1970s, i.e., gain as much labor-intensive industrial exports to the U.S. market as possible was to move two decades too late into the strategy of trade and development that preferential trade arrangement with the U.S. offered. By then, our neighbors had already preempted a large ground in our potential markets. Also, the climate for growth of international trade which was so conducive to the growth of these same neighbors became altogether different and certainly somewhat more restrictive.

These neighbors, the four Asian NICs, accomplished without the benefit of the same exclusive advantages their early industrialization patterns which capitalized upon industrial manufactures based on labor-using exports in the largest economic market — the U.S. economy.

The main culprit responsible for failing to perceive the advantages of developing according to comparative advantage was the movement away from a market-determined, or realistic, exchange rate policy. This was the critical policy variable for export and trade realignment. For exchange rate policy impacts strongly and immediately on domestic and foreign prices. Its effects, therefore, are quick and sharp.

Of course, any missteps could be corrected. The government, sensing the ill wind that controls brought, dismantled them and freed the exchange rate. Once-over steps always have the effect of realigning economic forces. The failure of our development policy in this

regard was to work with a given exchange rate and to support it for a while even when it had become an overvalued rate.

The corrective action seemed to lag rather than to lead. Even when the policy was to "float the peso," it was a "dirty" float, as others have observed. Actual market signals which tended to show that it was overvalued were ignored. As a result, the buildup of distortions and other obstacles to development cumulated.

After political independence was secured, and specifically when central banking was introduced in 1949, the monetary and financial linkage with the world market, specifically with the U.S. economy, was partly disrupted. The setting up of an independent monetary system was a necessary act of sovereignty. This is a universal experience for all newly independent countries. They have to devise their own institutions in order to develop alternative means of assuring that normal economic activities are not disrupted. In fact, of course, independence represents a historical discontinuity that all nations have to face.

The strength of capital flows which would have emanated formerly from the direct and indirect guarantees of American financial institutions was therefore disrupted. A degree of monetary and financial isolations was necessarily the price of independence and of central banking. But central banking policy need not have been any more autarkic than before.

For instance, with independence, Singapore devised her financial relations with the world by having a more open financial system. This had implications on the way other economic policies had to be directed. Singapore freed many sectors of economic policy and, although they adopted financial regulations, their system was an open international financial system. This system was based on preserving monetary stability and included a conservative fiscal and monetary policy.

The route chosen by our central bank was different. It could have taken advantage of the opportunities of the market, by linking the peso to its true international value and not pegging it sentimentally to its prewar parity with the U.S. dollar. Initially, such depreciation could have been seen as a weakening of the peso, then. In the long run, it would have created a stronger Philippine peso today.

At that crossroad in its history, the economic course of the country could have been altered. The Philippines could have been further helped by other auspicious circumstances. These include its relatively

high level of international reserves at the end of the war, propitious world trade events, large U.S. military spending for goods and services that lasted through the end of the Vietnam War in the early 1970s, and other spending notably by American military aid. All these could have laid the foundations of industrial growth that instead took place in Hong Kong, South Korea, and Taiwan one decade later — in the 1960s.

Of course, part of the problem was that, in the early years, like some features of Philippine-American economic relations, we did not have full monetary autonomy. We could not even touch the value of the peso without the consent of the American president as provided for in the Bell Trade Act. This was, as correctly pointed out by many observers, an infringement of Philippine sovereignty by a country that was supposed to be its benefactor. It was clear that such infringement was instigated by the need to fully protect the interest of the nationals of the former colonial ruling class in the newly independent country and constituted a mistrust of the future course of development.

As an independent country, we were not short of methods that enabled us to achieve what we wanted by way of policies. The independent action of imposing the exchange and import controls to preserve the value of the peso was one such sovereign act. In fact, U.S. interests complained to their government about these. And they presented a vested front whose views were considered by their government within the framework of the negotiations to revise the Bell Trade Act.

I attach to foreign exchange policy — the act of delayed adjustments in the value of the peso — the most serious economic policy error of our independence. In those days, the common wisdom among economists in the country was that we needed those measures to conserve resources. In adopting stringent exchange and import controls, we led ourselves into the domain of the pernicious cousins of all kinds of price controls that we found ourselves instituting throughout our independent history and even into the present.

In attempting to conserve resources, they were practically squandered. These resources were not properly and fully priced through the market. If government policy had insisted on their proper market values, the resources would not have been consumed soon enough either through the mechanism of feeding them as raw materials to newly promoted industries or simply through outright expenditure for consumption. Foreign exchange resources were made cheaper,

through an overvalued exchange rate, or government policy wished them to remain cheap to feed to preferred users. The result was a massive misallocation of resources.

Some parties, through their closeness to the powers that be in government who approved licenses to import, were able to get their foreign exchange and import allocations rather cheaply. The assembly plants that they built were thought to be the beginnings of a sound industrialization. But in effect, they were largely fed by raw materials that were imported. They also borrowed capital very cheaply, at rates which were lower than the scarcity value of capital, through the development finance institutions set up by government.

Hence, these industries received the highest form of protection through the control of competing imports and the availment of cheap credit and foreign exchange. In this sense, they were nurtured to monopolize a limited market. When the foreign exchange resources became scarce because the trade system was largely consuming foreign exchange and not producing it (witness the persistent balance of payments deficits), these industries became very vulnerable. Their raw material base became too expensive or were cut off. The result was that the same industries floundered and many failed to survive harsher times.

The cousins of economic controls therefore had their heyday in the early years of independence, and they have been nurtured up to the present. As will be shown in the following, their early beginnings and their continued survival in the economic policy package until today was marked with good intentions.

Good Intentions Behind Government Interventions

Government actions are initiated with good intentions behind them. This is especially true prior to the adoption of any new policy before any vested groups get established.

Some undesirable results may accompany a particular policy because it may be inadequate or misdirected. The policy may actually end up achieving a result different from what was intended. In this case, it leads to some effects that are not foreseen.

With respect to the operation of the market, this is how the patterns arise. First there is dissatisfaction with the resulting situation in a particular sector. This dissatisfaction sometimes leads to the joke that the government should repeal the "law of supply and demand." This dissatisfaction is sometimes perceived as an inefficient or cruel result of certain factors operating in the market. And the

presence of monopolies, as well as the inequitable distribution of benefits, is too obvious in this kind of perception.

On the ground that it is a public duty to improve the setup, the government sets up its own intervention. This could be in the form of trying to influence directly the reasonable prices or margins that private enterprises could be made to comply with. Such prices may be on goods or on factors of production. They could be price controls or guaranteed buying prices or minimum wages, in the case of labor, and maximum lending rates, in the case of credit. So long as the government follows the market in setting these price targets, things would go all right.

... In principle, a realistic intervention could lead to good results. But very often it does not. The temptation is always there to delay any desirable change. Once controls on prices are established, pressure groups are polarized. At one extreme are those who insist on maintaining the same policy of delaying any action, or reducing the extent of any proposed adjustment. And then there are those who seek alterations in the current policy that adversely affects them. A market adjustment would be much simpler to attain this. But with controls in force, the adjustments made are in hidden activities such as the reduction of the quality of service and the reduction of other associated costs, such as those in marketing. For instance, marketing costs could be shifted to the buyers or other enterprises operating in the distribution system. There can be a shortening, for instance, of working capital credit. Such hidden adjustments eventually lead to quality inflation which is not revealed by price regulation.

Wage Policy

When minimum wages were set initially in 1951, the idea was to raise a working wage to a "normative" level. This level was determined by Congress. What constitutes a decent working wage is an important question of public policy. But it is an intractable one. This measure deflects from the more fundamental and tractable question of promoting the employment of every one seeking employment in the labor force. When the initial industrialization set off in the 1950s (I hesitate to use the term "took off"), entrepreneurs were led by the existing policy to choose import replacing activities and to shun export-oriented labor intensive industries. The minimum wage and cheap credit worked together to favor mechanized operations in industry rather than the greater use of labor. To some extent the same attitude was promoted in the modernized sectors of agriculture.

When tripartite meetings are held by organized labor, employers, and government, the objective is to come out with an agreed form of indexed minimum wage package (including allowances, etc.). This package is in keeping with certain norms determined in the past (the working wage). Organized labor and relatively well-to-do employers in the private sector, who are refereed to some extent by government, undertake what looks like a bilateral monopoly bargaining process on that wage package. In this bargaining, the millions of unemployed, or those employed in marginal occupations and therefore wanting better employment and the thousands of enterprises that can ill afford to pay any more new wage increases, are excluded from this process. If the government did all it could to police the implementation of what it orders in the first place, many more enterprises would go under.

As a consequence, a large amount of new unemployment results. It then becomes far better for government to pretend to implement laws by justifying and setting up a large bureaucracy, and by expanding the Ministry of Labor and its bureaus. This sometimes allows the slowdown of the implementation process. Confronted with the reality of a high unemployment rate, as is true in the country, the government often finds itself trying to close its eyes and turning deaf ears to the full and strict implementation of the wage laws. In this way, a greater disruption in employment is avoided. But there is one result of this. It breeds contempt for the law and radicalizes all the more the labor sector which complains of exploitation. Hence, it contributes to the breakdown of respect for government and its policies.

Yet, when the proposed wage package is presented to the president of the Philippines for his ultimate approval, much of the bargaining process for wage setting has almost come to an end. The approval, which is expected, becomes the apex of a political process. It elevates an economic issue into the political arena. The president can disapprove the settlement or return this to the bargaining table. The course of least resistance is to show the concern for a sound bargaining process and therefore to approve what is presented as the bargain. The wage bargaining and indexation, which comes with the process of technical computations by government as part of the negotiating process, has put the president in some sort of a political trap. It presents him with predetermined figures that he would have to approve in the end.

In short, the economic process of wage-setting has become politicized. The same politization of prices occurs whenever the government steps in and mandates price ceilings and floors, in order to express a policy adjustment. The experience in this regard is very unfortunate in the long run. We shall now demonstrate this with other examples of interventions.

It can be argued that the ill effects of one policy, in this case, wage policy, can be offset by other policy interventions. The record of past policies, however, had been to exacerbate the bias of policies against employment creation, which is the major ill effect of minimum wages. Even today when great strides are being made to do away with some of the other undesirable aspects of economic policy, this bias against employment is still a major defect of overall economic policy. In Singapore, where a high wage is a major government policy, a large component of the high wage is captured in the form of forced savings. The contributions of workers and employers to the central provident fund have come to about 25% of the gross wage. But it is another matter to discuss the relative efficiency with which Singapore has used savings. However, these two aspects of saving and investment explain the high productivity experienced by this country.

Interest Rate Policy

Good intentions have kept interest rates under control for many years. This can be traced in fact to the anti-usury law in effect since the first decade of American colonial rule. As early as 1970, I argued the need for a fundamental reform in this area so that the *real* interest rate would always be positive. And it was only towards the end of my work at the policymaking end that interest rate reforms finally took hold. It was not persuasive economic argument on our part which worked. World interest rates soared. The country was engulfed in a world in which capital-rich countries also raised their interest rates. The successful economic miracle cases in our region spearheaded initially by high interest rates added to the validity of this policy direction. Hence, the only success was in bringing the discussion to the open.

While the exchange rate sought relatively market-determined levels, during the period of managed exchange rate float, interest rates were cheap. The interest rates at which the banking system and the state financial enterprises could dispense their funds were un-

realistically low, sometimes even negative when the inflation rate was taken into account. Therefore, borrowing from government financial institutions was an especially lucrative proposition if a project could be developed.

To obtain loans, therefore, it helped to have government connections. And the large category of “projects under government behest” even in the portfolio of these institutions indicates the magnitude of this problem. Today, these government behest projects are classified largely as nonperforming assets of these institutions. It will take enormous write-off losses for these institutions to put themselves back into operation. And in the process, they would need new infusions of government equity.

On the other hand, there was a free commercial paper (money) market in which interest rates practically floated. The government control of interest rates led to this highly dualistic setup, which was the natural result of financial repression in the formal markets.

The waste of domestic capital has cumulated over the years. The present condition of the state financial institutions that have undertaken this lending is a testimony to the ill-advised policies of artificially depressing interest rates in the thought that this would induce capital formation and produce the kind of enterprises needed by the nation for economic development. The policy had managed to make some individuals only richer by borrowing low cost development loans. It became a joke in the early 1970s (when I was new in government) that some piggery loans had financed some houses in Forbes Park. This may be an exaggeration with a grain of truth somewhere.

Sometimes this waste was manifested not so much in terms of the enterprises that were set up. The capital and raw material procurements used in running these enterprises and the device of concentrating management in the associated companies squeezed money and capital out of these existing enterprises. Also, the high rates of return in the money markets channeled private funds, including those obtained at low cost from the formal sector, like the governmental financial institutions. This produced additional fortunes for those who had access to the low cost funds. If interest rate calculations had been more severe, some of these projects would have been eased out by calculations of viability.

The triumvirate of factor pricing policies which were controlled by government — minimum wages, interest rates, foreign exchange, and import controls and, later, a managed exchange rate float — was

therefore undertaken because of good intentions. They were the result of an activist and compassionate role that government decided to undertake in handling the pricing matters with respect to various perceived needs in the main affected sectors. They may have been devised as short-term policies initially. But they eventually created monsters for the long term. These are the monsters that the present and future governments will have to grapple with. Their costs to the whole nation, as the present crisis is showing, are painful. Any one who fails to believe this will only have to recall the travails of the nation in the last few years while our neighbors in the ASEAN are having an unprecedented surge of growth. And we are embarrassingly south of the most progressive countries in East Asia — Taiwan and South Korea. The problems that wrong policies have engendered and cumulated over the years cannot be wiped out overnight.

Marketing Interventions in the Food Trades

By the same token, good intentions were initially the reasons for intervention in food distribution. In the early years of the republic, government interventions in food marketing took the form of imports of basic commodities. These commodities were put up for sale at low margins on the domestic market. Among these commodities were rice, corn and basic consumer items. For almost a decade, the country was fed with imported sardines and corned beef. These processed foods became basic consumer staples that could be bought in the local stores. This way, government marketing organizations, including those for rice and corn, whittled away precious foreign exchange and defeated the domestic production incentives in these wage goods.

It was a step in the right direction when import-oriented price stabilization policies were redirected towards domestic procurement. It was, however, a step in the wrong direction when the government, responding to short-term crises, such as calamities and oil shocks or exchange rate adjustments, stepped in to institute price controls and keep them there for a long time. The moment the controls were set in place, the rigidities of price ceilings in relation to increasing costs of production began to sap producer flexibility. Since adjustments in price ceilings were on a periodic basis, producers were placed in uncertain cost positions. The timing and extent of the adjustments were not predictable. Hence, when these were finally made, quantum jumps only fueled inflation.

When price controls were imposed, they were designed to be temporary. But the “temporary” in government seems to be much longer than common people normally expect. Most people move out of what they conceive to be poor personal policy at the earliest opportunity. This seems to be the case even when segments within government recognize the need to make the necessary adjustments. Government just takes longer to see its own mistakes. This is probably one of the norms of governing that can be elevated to the same level as Parkinson’s law. Measures justified as temporary take too long to correct. Governments try to overlook the urgency of measures to protect the interests of established vested groups. This might be a case of trying to wish away the problem. And in the case of these protective measures of market interventions, the vested interests come in and thrive.

For instance, price controls are easy for any government to undertake. It costs little in direct budgetary expense. But they bring up a whole mess which costs private citizens and businesses much more than is realized. Another pernicious impact is that they temporarily give some power to government bureaucrats. Sometimes this leads to opportunities for corruption. The power to raise price ceilings or to close the stores of “profiteers” gives discretion precisely to those groups in government that should not be allowed discretion in the implementation of policy.

Moreover, price controls stifle private initiative. They create a gap between government and the general public, such as when sellers cynically tell buyers to purchase their pork from the price stabilization council. They unduly induce social tensions among citizens such as when the decreed controls are out of line with actual prices and buyers and sellers get heated up quarrelling on the relevance of government-announced price ceilings. For instance, in long-term relations, the most difficult social tensions were probably generated between tenants and landlords in rent-controlled dwellings because of their intermittent, long-term relations. This leads to the next item.

Rent Control

Good intentions also brought about the policy of “rent control” for apartment dwellers renting at less than ₱300 per month. Rent control created a strong wedge between dwellings offered for rent at this cutoff level and housing for other relatively poor families. As a result, an artificial housing gap mushroomed for middle income housing; the situation was not as acute before. Another major result

was the heightening of social tensions in poor neighborhoods between tenants and owners. Today, there can only be a much larger housing shortage in the country.

The solution to the rent control that was applied some six years ago to alleviate the matter was to allow a 10% yearly increase for a period of five years. Before that, the law provided a complete rent freeze. This could only temporarily alleviate the situation. Over the years, investments in low-cost housing were undertaken by proprietors and middle class individuals. These investors in property included government officials who put their retirement money into inexpensive housing. The experience in rent control and rising urban property taxes have jointly created the disincentives to housing investment of this type. Now, those brave souls who still want to build apartments for rent specialize in higher rental dwellings so that rent control levels would not reach them. But will assurances that rent control will not be imposed again be sufficient to make persons with extra savings go into this low-rent housing industry? It will take a long time before people again allowed themselves to be trapped.

Control on Educational Fees

Aside from the regulation of standards, the government has intervened also in trying to directly control the cost of education, especially at the tertiary level. The first area of direct influence was in imposing price ceilings on educational supplies. This was intended as a consumer price control measure. As a result, the quality of school supplies has been adversely affected. Controls created incentives to alter the sizes and nature of the paper used in the manufacture of school supplies. Producers moved into the production of highly varied items of school supplies with much bigger prices. The overall result was a higher cost of school supplies.

Concern for the reduction of tertiary educational costs led to the control of tuition fees. The result has been to put an unnecessarily severe strain on the private higher educational system. This is demonstrated by the recent case of the University of the East. This university's problem arose because of a legal problem stemming from the provision of salary payments to professors in view of tuition fee controls imposed by the government. While the entry of the Maharishi group provided a different color to the UE episode, the financial problems highlighted by the situation exposed the dangers of tuition fee control in the private educational sector as business establishments. The private school sector, especially at the tertiary level,

has over the years provided a mechanism for absorbing into the educational sector Filipinos who could not be accommodated by the publicly-supported higher education system.

Tuition fee controls arose out of the best intentions of well-meaning individuals who wanted to reduce the cost of education. Price control here has affected the effectiveness of rendering improved services in education. The quality of teaching suffered and premises deteriorated. If there were a more rigorous study on the matter it would show that, overall, there had been a general decline of services in the educational sector.

The current liberalized regulation now being undertaken to allow schools to raise their fees could only be a temporary relief. The ideal situation is to deregulate tuition fees completely while the educational authorities continue to enforce standards. There is enough competition in the process to keep tuition fees in check. And there is enough market differentiation among standards in the different schools so that quality competition, in the face of cost realities, continues within the school system. What is important is to maintain minimum standards.

The tuition fee freeze has provided some sectors, notably the radical student sector, with an issue to capitalize on. Yet in many countries where it is customary for public universities to charge partially for the cost of education, tuition fee increases escalate depending on price and cost changes as perceived by university authorities without interference from the authorities and also without giving way to student outcries, boycotts, and barricades.

Trend Towards Monopolization: Public and Semi-public Monopolies or Near Monopolies

We should now turn to other governmental policies which led to the monopolization by public and semi-public authorities of some industries. Of course, the cases of the sugar and coconut industries are already understandably well discussed. Much debate on the merits of these agencies and marketing organizations has been made and there is little need to elaborate. Moreover, new light will probably be shed when the Batasang Pambansa takes these two industries to task through public hearings that are being scheduled. The agencies and marketing organizations that have been established do not require any prolonged discussion.

There are only two points of interest that may be worth taking

into account on the role of governmental monopolies in these cases.

The first point is accountability. Accountability refers essentially to making appropriate records of activities and transactions so that officials can be rendered responsible for their actions. One could define accountability here in the "public" sense, but it could simply be "industry" accountability. If indeed these two monopolies were set up with the interest of the people at heart, then they should be able to satisfy an elementary sense of accountability to their constituents. It is an elementary rule for any group with a public purpose to keep a record of their operations, including their resources and their expenses.

The sense of "public" accountability cannot be dismissed lightly either because government funds or public resources have been expended in supporting them. These two monopolies can survive public criticisms about their operations or problems if they can satisfy the accountability criterion.

The second point is centralization of the decision-making process. Monopolies would be perfect setups if their managements were error free, that is, if their judgments were perfect. Any decisions affecting their operations would be in consonance with the public or industry welfare in mind, in short, with "accountability" in mind. But supposing such were not the case? There can also be errors in judgment because of risk and uncertainty.

When monopolies commit even honest errors, they are centralized and are therefore very costly. Centralized mistakes are the worst that can happen to a large industry upon whose livelihood would depend many traders and products and millions of workers and their families. It would be far better if there were several independent decision-makers whose mistakes cancel each other out. In this case, the components of the industry concerned would end up enjoying or suffering what the "average" would have taken.

The theoretical justification for a monopoly is that it enjoys economies of scale because of a falling average cost curve. A monopoly arises naturally under this condition since any increase of output or of service is accompanied by a falling average unit production cost. Further, the activity may affect a large part of the national welfare (so that some monopoly power could in fact be wielded). In this case, a public interest viewpoint is involved.

In an imperfect market, such as in a trading situation, in which some merchants or traders are perceived to be taking too strong a position and are in fact exercising some monopoly power, the temp-

tation is for government to substitute "control" of the process for regulation to insure competition. This is a perennial trap that government faces. And certainly the Philippine government has faced this problem many times before and now.

An Example of Food Marketing Distribution by Government: The National Food Authority

Another example of a government agency that gradually expanded its control over segments of the food industry is the National Food Authority (NFA). It first started out as the National Grains Authority (NGA), which was created to intervene in the grains business. This was a price stabilization agency designed to ensure that grain supplies for domestic consumption were assured and to stabilize and improve the incomes of the country's staple grains farmers.

Domestic interventions in the procurement of grains could be justified for reasons of domestic food security. This would require the buying of grain at the farm level at a guaranteed price. This has the effect of assuring farmers about their revenues from harvests. At the national level, this gives to the government effective control of a part of the year's grains at government warehouses.

In the mid-1970s, the NGA took over the full importing program for wheat grains. The idea was justified partly to improve the bargaining position in securing wheat supplies from other suppliers which are oftentimes grains marketing boards controlled by the government. Hence, it made sense to have the government step in, even if only to put the weight of government behind grains purchases abroad. There were also other reasons advanced by government. One was to reduce the trading margins enjoyed by the flour milling industry. With bulk purchases assured, it was argued that better bargains could be struck with the suppliers. The result was that the agency took over a large part of the grain marketing program from the flour milling industry.

The NGA took over a goldmine. The wheat trading operation was much simpler than domestic grains procurement. The activity yielded trading profits unlike domestic grains procurement. One major impact on the flour milling industry was that one part of their operation which tended to cushion them against losses in bad times was taken away from the flour milling industry. This was lost by fiat and regulation to government.

The reason for the takeover of the wheat trade was to reduce the price of wheat products via the removal of the middleman and trader

and via bulk purchasing from suppliers. Did this mean that wheat products, especially flour, remained low and stable? The wheat grains import monopoly did not necessarily wipe out the marketing gains of middlemen. It transferred part of these marketing gains to the public sector. These gains redounded to the public weal with the construction by NGA of a larger network of grain warehouses in the 1970s. As the agency gained more and more power over the private sector which it regulated, however, it became the problem rather than the solution.

In 1981, the National Grains Authority was converted into a National Food Authority. Only too conscious that such a broad-ranging agency was returning the food industries to ever-widening governmental grip, I did not recommend this action. But it was nonetheless created because the pressures for having a broader network of control and regulation for the food industries originated from groups in government who wanted to have a direct influence on food distribution. The NFA powers were so broad-ranging that it was only a matter of time before the agency would exercise them in order to regulate the food trade.

Such regulation is disastrous to the industry and to the general consuming public. A letter published in *Business Day* on 14 November 1984 will describe better the state of the flour milling and baking industry. It seems that the letter was written by someone knowledgeable about the state of the industry. Considering its delicate nature, it looked pseudonymous, judging by the first paragraph:

To openly disagree with NFA (in a public conference) would mean a big reduction in their wheat allocation.

Main causes of flour shortages have been traced to NFA's wrong timing and inefficient scheduling of wheat shipments; availing of cheap but inefficient shipping companies; and importing more soft wheat which is not needed in the market. The said soft flour is now being forced on reluctant bakers.

Now, when wheat supply is more than enough, NFA has no more reason to continue handling flour distribution. NFA should now concentrate on its original function as a regulatory body and take necessary steps to control the rapid increase in the price of rice and corn which NFA seems to have neglected.

If NFA wants to raise revenues or minimize losses because of inefficiency, it must streamline operations, reduce drastically their representation expenses, PR expenses, and other non-related expenses. It must watch closely the spoilage and pilferage of goods in NFA and FTI

(Food Terminal Inc.) warehouses which have contributed to the big losses of NFA and FTI.

Claims made by NFA that 90 percent of members of the Federation of Filipino Bakers Association are happy and support the allocation is not true and grossly exaggerated. Only those bakers who have big allocations and special privileges enjoy the system. Most bakers are complaining . . .

NFA must not grab the livelihood of legitimate businessmen. This is inconsistent with our government policy of *sariling sikap* and free enterprise.

The NFA experience recalls nothing more than what is predictable from any highly centralized organization. When a government agency engaged to control a particular trade also decides to participate in that trade, the rules of participation becomes more centralized and are built-in in favor of the regulator-*cum*-intervenor. The centralization of procedures and controls, which emanates from a desire to directly affect many aspects of an operation, oftentimes degenerates into a disruption of already existing channels of distribution.

The food trade at the retail level is one of the most decentralized economic activities. It is more or less competitive. Many practices of trade developed over the years through customer relations also exist between suppliers and retailers. These relations are oftentimes linked through a network of informal credit. The smallest units of retail, which belong to the self-employed family workers, are the ones that suffer most when the government takes over a function and disrupts the system. These small traders lack the resources to deal directly with the NFA. Yet, because of the centralization of procedures of securing their flour allocations, for instance, they also lose their credit and access to suppliers.

The Kadiwa Program Analyzed

From the control of food distribution at the wholesale and regulatory level, the NFA now has gone to the retail level. To help relieve the urban consumer from the realities of inflation, the NFA caused the establishment of small retail outlets at the community level. The results are the much publicized *kadiwa* stores, which are designed to compete with retailers. The ultimate impact is to compete with the backbone of the community retail store, which is the most labor-intensive family labor establishment — the small *sari-sari* neighborhood store and the medium-sized grocery.

By setting up the kadiwa, as part of the distributive network of the Food Terminal Inc., the NFA hoped to reduce the prices of prime commodities that enter the common food basket of the consumer. This intervention goes in direct competition with the private sector. Although the private sector stores will eventually survive the competition, it is likely that the kadiwa will not survive it, because its operation is based on subsidy, and that subsidy is not infinite. The kadiwas are also observed to be operationally inefficient, unlike private retailers.

In order to set up and support the kadiwa stores, the NFA, through its subsidiary the FTI, had to increase investment for new buildings and new transport equipment, and to raise its working capital to hold inventory. In addition, it had to hire additional manpower. The financial resources (for grains procurement) of the authority, which was originally designed to oversee the domestic grains intervention program to assure the country of adequate rice and corn supply, were also affected by this new expenditure.

The scarce managerial manpower of public authorities could be diverted to attend to the other problems not germane to regulation and to direct agency operations. This retail distribution activity competes with the livelihood of the poor end of the food retail distribution network, the very backbone that the government wishes to help with its so-called *sariling sikap* program.

The kadiwa stores are state enterprises that compete with private enterprise. In a sense, they are so unlike the private stores. The small, privately owned stores are normally filled with stocks of goods for sale. They use their space relatively well. In contrast, the kadiwa stores have more empty shelves. The fresh food (e.g., vegetables) that they carry often rot or dry. And the meat they carry (like pork) may also reach the limits of its freshness. However, some goods, especially canned food, are cheaper in the kadiwa stores than in private stores. The above comments are not based on hearsay alone for I have personally visited some kadiwa stores.

The illusion that kadiwa goods are cheaper is only momentary. Kadiwa operations reflect on the income and balance sheet statements of the NFA and its subsidiaries. The moment the expenses on buildings, equipment and personnel are taken into account, certain losses would inevitably make themselves manifest. Who, then, ultimately pays for the costs of this overhead? Although the NFA will deny that there are direct subsidies being paid to finance their operations, the kadiwa program will be sustained because of the opera-

tional capability and overhead facilities built by the NFA and the FTI. This is where, in the final analysis, the subsidy component can be derived.

The real justification for the kadiwa program is political rather than economic. On surface, it shows the concern of the government to bring down directly the prices of basic consumption goods. But even on this account, the results are not promising. When items do not appear in the shelves of the kadiwa stores because of scarcity and these are available in the other stores, who gets the blame from the people? Naturally, the government.

NFA represents an important example of the growing interventions in businesses that had better be left to the private sector. Here is an agency which has direct contact with the most common people, the consumers. In effect, it touches the daily lives of the citizenry although this may not be realized by many. The food trade is largely composed of very small firms. These firms represent a large segment of the general population, most of whom employ only themselves or family workers. In effect, they compete with the large segment of the poor population in their business. The NFA became a mammoth regulatory and competing enterprise to the very sector whose operations it was supposed to help regulate.

This example of a changing public agency is not an isolated one. The same examples are repeated in many countries in which well-meaning efforts are made to intervene in a supposedly significant trade dealing with basic consumer food essentials. The lessons from interventions of this type toward general public welfare should be well known by now. In the 1950s and 1960s, the country also suffered from the misallocation of resources by marketing agencies that were originally designed to protect the consuming public. The legacy of these agencies was to create production disincentives in the private sector. Their overall long-term effect was to make food supplies less readily available. To some extent, mismanagement even caused the instability of supplies, thereby leading to contrived scarcities. In the end, therefore, food prices only rose in the long run. The example of flour and *pan de sal* is too current to forget.

Deviations from Competition and Uniformity: Private Monopolies

There have been cases of exclusive privileges within the private sector that have no public utility justification. The occurrence of these cases, however limited, has undermined confidence within the affected segments of the private sector. While they may have been isolated cases, the fact that they have occurred has given rise to the charge of double standards: one for special parties and another for the general public.

Some commentators, including the critical press, have lumped this under the topic of "cronyism." A large segment of the dead-weight loss of the Philippine economy can be identified with some prominent cases that have been associated with this phenomenon of "crony capitalism." But the phenomenon extends to a wider set of persons and entities when put in the context of some general policies. The biggest industrial failure, the Marinduque Mining and Industrial Corporation, for instance, could not have qualified under the category of cronyism. It was a bold industrial venture mistimed with the energy crisis and the world recession of the 1970s.

The granting of special favors may have been encouraged by the absolute nature of the decree-making power. When institutional checks are not fully in place or when there is confidence that such power could be relied upon when needed, favoritism could spread. Certain parties close to the ruling class were thus able to manipulate their advantage at the expense of others.

Such actions have put the leadership at a long-term disadvantage. Perhaps in retrospect, in the light of what some of the excesses had brought upon the nation when the economic crisis struck and exposed the problem in the open, such practice could only have been regretted. They happened because of the tolerant atmosphere in favor of the close circles within the ruling group. Such a tolerant view would not have flourished if there were more institutional checks that functioned well without exception. But that seemed to be the crux of the matter. Institutional checks simply meant that the proper procedures for getting the relevant agencies of government to pass on their recommendations before any decision was made were being followed. This procedure is standard, but exceptions could, and did, occur. In fact, for special groups, the bypassing of this essential procedure explains why some expected results did happen. In these circumstances, the institutional process of advice and coordination was left with situations of *fait accompli*.

In any government, it is not unusual for any group with special access to those in political power to promote their own interests. Normally, however, it would be difficult to cite any evidence of special favor. Silent patronage is often the most effective norm. The exercise of patronage, therefore, need not appear in the books of government. Under the setting of absolute decrees, when these are not carefully used, there could be lapses that would allow special discrimination. For instance, some officers of government have to perform certain tasks that are not in accordance with existing policy. Only a direct order from a higher authority would enable lower officials to deviate from standing policy through exception. Some times these orders take the form of a decree or a letter of instruction.

Some groups in the private sector therefore have legitimate gripes when they complain about the discriminatory treatment against them. A government must show fairness to all concerned as a matter of equity. This is a legal, not an economic, point. A government which relies more on the impersonal workings of the competitive market can assure its citizens of fairness by minimizing governmental interventions, including the giving of direct favor.

Some of these special favors might be simply under the euphemism of "orderly marketing arrangement," as in the case of the special private company set up as a joint venture of a private group with the Bureau of Animal Industry to have the monopoly of imports for meat from Australia and New Zealand. Like the takeover of the wheat import industry by NGA, this measure transferred private trading operations to a special group.

It would be interesting to study how a cigarette paper manufacturing venture got exclusive tax free privileges to import cigarette paper, thereby conferring upon it the absolute power to knock off any competition in the same field. This enterprise reaped enormous profits in its operation since domestic cigarette manufacturing is a large industry. It is therefore not strange that on this basis the owners of this company were able to build a large industrial conglomerate which, incidentally, collapsed. It would be interesting also to find out if the same profitable cigarette filter company was among the bankrupt enterprises in this conglomerate that was taken over by government through the National Development Company.

Under the excuse of providing cheaper means of educational communications in the rural areas, a black and white television manufacturer was given special duty-free import privileges. This affected the domestic market of the television manufacturers that

were supposed to receive preferential treatment under the Board of Investments.

The Ministry of Transportation and Communication should study the rate structure for an exclusive franchisee, a closed company, that is in charge of satellite communication transmittals into the country to determine if such rates of tariff are fair or exorbitant and if such rate structure affords an inexpensive link of the domestic telecommunications center with the international satellite telecommunications, given the revolutionary technological changes in the field. Is the country paying too high a bill for satellite-transmitted telecommunications?

A celebrated case in the Bureau of Customs some years back was that of a soft drinks bottler, one of the big colas. This company was given tax free importation privileges for bottles manufactured from a neighboring country. This was designed to give the cola distributor some competitive advantage. The bottles that were locally produced were too expensive and manufactured by a conglomerate cousin of the other cola-bottler.

Special laws are created to enable private companies to obtain certain privileges from government on a nondiscriminatory basis. Under established procedures, these privileges are administered by specially designated government agencies, such as the Board of Investments and the Tariff Commission. If these agencies are guided by policies that allow competition and the market system to prevail, they can tailor the policies so that their actions would promote rather than reduce competition.

For too long, the proposition that a country like ours cannot tolerate competing enterprises because of a limited domestic market has been interpreted to mean allowing few competitors or only a monopoly. This leads to an undesirable result. It allows unfair advantage to be derived by a producer over a captive market. The competitive solution is to allow some degree of tariff protection while imports are made to compete with domestic manufactures. The efforts at tariff restructuring are clearly in the direction of improving the setup.

For years, I have argued in favor of this direction, if only to improve the system of protection and to remove the distortions that have been found to exist because of unequal protection and the high cost, poor quality local import substitutes that our industrialization program has promoted. This should have been done much more quickly before the mid-1970s. But government takes ever so slowly

to convince and even then only if some offer of a *quid*, like a big loan from the World Bank, is available. Doing good for the economy should not require waiting in general.

But this is water under the bridge. I am glad to some extent that corrective steps are currently being taken. The only unfortunate thing is that it gives credence to the charge that the measures were taken on the goading of external institutions rather than because they were desirable to begin with, as indeed they were. From my own viewpoint, their desirability had never been in question.

The element of monopoly privileges is still allowed by government to be exercised under the guise of protection. While enormous incentives are already available to help out enterprises, certain privileges, like requiring tariff certifications prior to importation to ascertain the availability of domestic substitutes, are given to agencies. These agencies, in turn, would make a decision based on information supplied by the affected company as to the availability of adequate local supplies.

Take the case of the largest paper and newsprint manufacturer. This company has been given virtual monopoly over the newsprint market in the country. Time was when our newspapers were among the best presented in the Asian journalistic market because they were at least printed on good newsprint. But the government has given this company virtual monopoly over newsprint production and distribution. In fact, there was a time when this company was allowed to import newsprint which, together with its production, controlled the supply on the domestic market. Newsprint imports are not allowed at times and their tariff rates are already high. As a result of this, the local newsprint maker had little incentive to improve the quality of newsprint. And among ASEAN countries today, the Philippines has the distinction of having the worst newsprint on which our newspapers and other school supplies are printed.

Just recently, the new Philippine cocochemical venture was given the exclusive privilege to import alkyl benzene, a petrochemical product used in the production of synthetic detergents. If one had the patience to review the tariff code, it would be easy to find provisions of the following kind: a commodity import would be entitled to a lower rate of tariff if certified by the Board of Investments.

Ultimately, this procedurally means that the Board of Investments, with consultations or judgment on its part, would determine if company X is capable of supplying the competing domestic prod-

uct. If the producer is persuasive enough, or if a bureaucrat determines independently that in any case the product is produced locally, the imports could be judged as unnecessary and wasteful, even if the price is better and the quality more assured. In such cases, it would really be so much better if actual tariff rates, compensating taxes, and antidummy duties (if dumping could be proven) could be applied, given a prevailing exchange rate which is presumably not overvalued. This is far from the so-called "free trade" solution that some careless critics on the scene harp on as the main objective of the tariff restructuring program.

The price mechanism would therefore play its role and no government regulator need ever control the process through his signature or assent. It is monopoly power of the regulator, or as transferred by this regulator to the private enterprise, which reduces the competitive urge and therefore penalizes the whole country in the end. When a company, which is already given generous tax and other investment incentives, is further given additional control over the life and death of companies consuming a product that it produces, through privileges granted by the state or its instrumentalities, it creates conditions that make them automatically earn profits even without half-trying. The instruments of tariff protection or antidummy measures should be made to fulfill certain tasks. But the power to determine the fate of other competing users should not be left to them or to the state bureaucrat. This is the kind of power which is promoted by the use of tariff certification procedures which those in the private sector who need imports to sustain part of their operations understand too well.

The Planning and Implementation Processes: Resources and Public Expenditure Control

Under martial law, the capacity to generate public resources to pursue government programs improved. Early in the 1970s, organizational changes in the planning machinery made it easier to streamline the activities and functions of government. The planning machinery was strengthened. Compared to previous years, there was greater coordination of the economic programs. Government corporations were revitalized and some new ones were created. These changes were designed to carry the mandate of development more effectively.

The taxable resources of government improved. Changes in the domestic tax system were made. An enlargement of the tax base was

achieved, covering, for instance, a wider field of agriculture, trade, real property ownership and other hitherto untaxed areas. The basis for the kind of dedicated, no-nonsense development that had taken place in such authoritarian governments in East Asia that are now classified as NICs became available to us.

What went wrong? To some extent, the failures of policy to use the market more effectively, which is the theme of what has been said so far, have a big story to tell. But all that is not sufficient. Many other factors converge together to concoct a kind of "witches brew" in the emerging saga of Philippine contemporary history. Shifting priorities, changing expenditure strategies, towering personalities: all of these contributed to this concoction which led to the results. We shall briefly discuss aspects of this brew by relating it to the planning and implementing process. In this way, it is possible to examine the effects of these developments on the nation.

The improved capacity to raise financial resources through taxes and other forms of saving was not matched by the same quality of control over public expenditure and private investment. Among the important reasons for this phenomenon, it is possible to refer to two: (1) overconfidence, and (2) defects in the economic decision-making machinery. These points require elaboration.

The government in the early 1970s was in possession of viable governmental programs designed to raise the level of public and private investment. The country built a good credit standing from external creditors and foreign investors. Public confidence in the development orientation of the government also grew. Such confidence also emerged somewhat from that unquantifiable variable that can be associated with the term "political stability."

The initial results of martial law led many to believe that economic discipline and progress would at last follow. In spite of the oil shocks, the programs designed to improve the overall infrastructure in transport, agriculture and irrigation, power and industry continued to dominate the picture. This gave a coherently confident picture of the way the economy was being managed: government investments were being made for productive activities. Thus, the direction of these investment programs exuded confidence among local business. Among international business concerns seeking opportunities of profitable expansion overseas, the Philippines was becoming an attractive proposition. In such an environment, private investment grew.

At this point, the country's international credit rating was in

good standing. Loans for many projects including those in the private sector became much easier to obtain, especially if these were obtained under government guarantee. The public borrowing program was worked out with the international public agencies, the World Bank and the Asian Development Bank, and the bilateral public sources, principally the development assistance institutions of the United States, Japan, and other friendly countries. These loans were largely designed to finance projects identified in the Development Plan. All of these loans were basically prudent and well within the long-term repayment capacity of a growing economy.

“Overconfidence” breeds further exuberance. One very influential sector in the government arose to affect the directions of public spending. This was a sector that propagated the theme that finance is only money and that money is no problem. Ergo, there must be concern for beauty and elegance, whatever the cost. As any one will recognize, that is hardly a theme that could be attributed to the prime minister or to his co-workers in the economic management team.

The result of this misdirected activity was the undertaking of non-productive investments associated with the government, arising out of competing programs of expenditure that were neither found *directly* in the budget nor ever conceived in the development plan. They utilized government resources, through support of programs undertaken by public corporations whose funding was raised either through equity funding by government or through bond financing.

If there is any negative influence on the credit rating of the country which could be attributed to a factor that could have been controlled, this is the sector. But this was only under the control of the leadership. It is this sector that has given the country the image of extreme profligacy before the world. This image was very hard to reconcile with the relative poverty of the nation and with the efforts to finance the development program by supplementation from foreign savings. With widespread travels and retinues, elegant celebrations and festivals, high profile, supposedly people-oriented programs involving expensive public subsidies, the more was seen, the more was said. And the result was not complementing on the development efforts of the nation.

As a result, and not too prematurely, the nation is “gifted” with an international convention center out of proportion to its need, a large film palace that is a vain imitation of the Parthenon in Athens, many specialized hospitals clustered together but designed to cure

separate organs of the human anatomy. There is a government-owned university that is nothing but a public embarrassment both before our people and before the world. This is a university with no faculty essentially, but which has been endowed with first rate buildings and the best sports facility. This is the same university ostensibly established for the common people in a setting that is supposed to enrich their lives. Now we find the further embarrassment of its premises being used instead to educate the children of the very rich Filipinos and foreigners in the country under the auspices of the exclusive, alien-sponsored Brent School. And, of course, this university was established by the same group trying to preach that the country's programs must address the 11 basic needs of our people.

These projects may seem peanut-sized in their direct effect, considering the total magnitude of government undertakings. But they have a large indirect impact. One side effect is that they have encouraged a culture of extravagance in many ways within government. When examples are available for the faithful followers, imitation becomes a cheap and accessible art.

These activities must have cost the country a margin of higher cost in international credit circles. The cost of Philippine debt over LIBOR in the international finance market, which rose as other factors made international lending more difficult, might have been partly affected by the high profile extravagance in some sectors of government. The government could not finance large-scale projects that are not even mentioned in the development plan and, at the same time, plea before international lending institutions for counterpart peso financing for development projects (which was getting difficult to raise). With the show of ostentation, international lenders did not give the country a good rating. Hence, they were constrained to tighten their terms, implying higher risk premiums, for loan syndications involving the Philippines and its institutions.

Of course, other governments all over the world are guilty of sustaining aberrations in their expenditure systems. Such aberrations are obviously justified in some other contexts, for instance, political. These are the areas that are normally not treaded by the economic adviser. In any case, they affect the quality of the turf in which the whole government operates.

Many projects undertaken in the private sector during the 1970s, especially those that require a large quantum of capital investment as the later experience revealed, had been of poor quality. It is fair to

state that some fortunes were made by those who only initiated projects and procured machinery rather than run enterprises. In some cases, the viable operation of the enterprise was not a major consideration of the project proponent. This explained part of the problem within some segments of the private sector, especially those with access to large loans and guarantees. This is not to condemn the private sector but to point out that some segment was more interested in the quick profits from procurement. In some cases, it seemed easier to default on the obligations and leave to the government financial institutions the problem of holding the bag.

This was, of course, far from the intentions of the government. The private projects were supposed to add to the productive capacity of the private industrial sector so that the economy could be stronger. Prime Minister Virata had tried to explain this matter in what turned out to be a statement too difficult for a man of his position to make, when he appeared about two months ago before the Philippine Chamber of Commerce and Industry.

Neglect is too strong a term to use. Overconfidence and misjudgment would be more apt in describing the failure to estimate soon enough the impact of the impending problem. Signs of these already manifested themselves during the Dewey Dee fiasco in 1981 and 1982. This affair had caused the government to undertake defensive measures that were strong but not strong enough to cure the large problems that by then had cumulated. One signal that could have helped but did not was the country's foreign exchange reserves. They turned out to be much lower than they were reported to be. The magnitude was large enough — later reports put it at about one billion US dollars — as to create a self-deluding effect on the quality of the economic management of the crisis.

If the signals were properly read soon enough, the painful measures of retrenchments and adjustments would have come sooner, too. The added presence of salvaging private companies that did not manage their affairs correctly actually reduced the fiscal flexibility of the government. Already, the legitimate development projects in the pipeline had suffered by then.

Disruption of Planning and Coordination

It is now essential to go to the main point about the disruption of the economic decision-making function. One effect of the enlargement of the government machinery and the expansion of the public

corporate sector is the creation of different centers of coordination. The ultimate coordination should have been exercised within the NEDA and the Cabinet. In the 1970s, as well as today, the normal institutional controls have already been in place, either by development or by past tradition. If these controls are relied upon in the assessment of governmental projects, a greater degree of consultation and accountability in the government may arise. These are two very essential attributes that improve the soundness of public undertakings. But these steps are at the cost of speed in decision-making. At the beginning, coordination was relatively strong.

This form of control was weakened as the 1970s rolled on. Stronger personalities in the government began to gain much more direct access to higher authority for their pet projects and proposals. By allowing the bypassing of this institutional network of the government, the planning and decision-making machinery, which began auspiciously early in the decade, was weakened. As a result, many new institutions were established. Some of these institutions carried powers and functions which ran counter to some established policies of the government.

For instance, the most common violations were those that pertained to tax exemptions and the power to borrow. Eventually, these decrees were corrected partially, to conform with financial policies. But the financial sector was only a part of this problem. This was easier to prevent because the direct costs of tax exemptions to governmental operations through a drop in revenues or lack of control of borrowing authority could be forecast more quickly. Hence, the Ministry of Finance was able to manage some of these problems. It was harder to monitor the implications of changes in the composition of cabinet committees designed to review certain problems especially in cases when the coordination process weakened. This happened when the lead agency failed to lead or take it upon itself to work without the others.

Odd as it may seem, such cases often occur. Inevitably, with the lightning quickness of the decree-proposing sectors, proposals were not properly sieved through discussion and debate, and a large part of the work of the major economic officers were taken up in what could be euphemistically called "firefighting." It is a large misallocation of time when the major economic officers are fighting fires rather than managing large issues and strategic problems. Firefighting could be reduced by appropriate coordination.

Perhaps the absolute decree-making powers had sometimes encouraged the bypassing of institutional consultation. Proponents of new laws can be very impatient and blame "pussyfooting" on the institutional network of the bureaucracy. It was therefore very tempting for higher authority, given this pressure, to decide before sound advice came or was resorted to.

The result of this was the premature buildup of expenditures by some government corporations ahead of those that would naturally have come from the normal investment and expenditure pipeline. There were cases in which less desirable projects or activities got the financing ahead of those pinpointed in the development plan. Recognizably, in any government, there are pushes and pulls everywhere. But when the tugging and pulling are not within sight or control of the coordinating agencies, there is no effective redress or defense. Thus, instant approvals for some projects happened. As in westerns, it became a case of the "fast guns" outshooting the slow ones. The slow ones fail to get their slice of resources.

The gradual deterioration of basic services in government is accounted for partly by those factors. In recent years, too many projects of marginal value had diverted the use of normal budgetary resources that should have gone to basic governmental ministries, such as education, public health, and police. These services should have grown in quality as well as quantity. Over time, the salaries of government employees have deteriorated in real terms because of inflation. Workers in those ministries have suffered much more, and to some extent their salaries have even lagged behind average governmental salaries.

A high point was reached in 1978 when the Ministry of Human Settlements was created. Eventually, the coordination of the economic programs of government became more difficult. Sometimes, the power centers gave conflicting commands. In any case, the flow of budgetary resources moved in a predictable direction: larger budgetary flows were being funneled through this ministry, including the coordination of some budgetary activities of several ministries, and of several new corporations that emerged under its wing.

This year marks the first time that we are again importing rice. The climatic factors of 1984 have played an important part. Destructive typhoons hit rice growing regions. But more than this is involved. The rice growing program of the government has suffered from relative inattention because in the last few years much of the support and funding for programs has been directed to the programs that

were pushed under the Ministry of Human Settlements. Since mid-1981, all of government was talking and channeling resources, especially in the rural areas, to KKK livelihood programs. Traditional programs such as rice growing, which received so much impetus from governmental support before, began to get less attention. In fact, the extension services had been partly affected by the shifting priorities and programs being developed to support the KKK programs. Even the NFA, which has been much discussed, was devoting more attention to new programs like the kadiwa and wheat procurement.

In due time, many analysts will have to turn their attention to this interesting, and very unfortunate, phase of Philippine economic history. Those in the field of government and public administration, with the help of economists, would have a field day analyzing this topic. The Batasan hearings on the 1984 budget, especially in connection with this ministry, and recent news about some corporations under it, have brought into the open some interesting activities that may show only the tip of a large iceberg. Within this ministry is the conglomeration of the most dispensable public corporations in the present government. They have cost the nation a considerable sum. And if liquidated today to save for the future, such liquidation will still cost the nation more.

Concluding and Further Remarks

Many factors explain the present economic crisis. For us to address our present problems correctly, we must face the roots that caused them.

External circumstances have made the economic performance less favorable to growth. They were not sufficient to cause a crisis if strong adjustments were made early enough. Such adjustments could have made good use of the market mechanism to solve many of the economic problems. Political factors, such as the assassination of Senator Aquino and its aftermath, caused a crisis of confidence on a wide scale.

The basic health of the economy had been eroded by years of inattention to the most critical problems requiring economic reforms and by the postponement of policies that would have been helpful. The active pursuit of unnecessary market interventions and the monopolization of several critical sectors, rather than competition, conferred special privileges on certain sectors. This, in turn, helped to

stifle incentives and contributed no less to the frustrations and inefficiencies in the private sector.

To add to these, certain sectors of government followed a parallel and competing program of expenditure which was wasteful by any economic standards. This was done by wasting government resources in projects of little social and economic productivity. Competition with productive investments of this profligate program reduced the effectiveness of government efforts in several areas. These projects are highlighted by the architectural wonders that were rushed for Metropolitan Manila and the world to see.

In addition, there is the tendency to undertake ill-conceived mass projects, for instance, in the guise of "livelihood generation," as if that term were only recently discovered. These projects ignored the lessons of past failures. Catchy acronyms accompany these projects so that they could partly be illuminated through high profile public relations media advertising. In the end, of course, true development proceeds only when people have improved employment and income and when they begin to learn self-reliance in a meaningful sense.

The development program which emanated from the planning sectors of the government had been generally of sound direction. Because the competing programs of wasteful sectors of government had edged out some funding for other more productive investment, the average productivity of government resources fell. The effectiveness of government in increasing economic and social productivity thus suffered.

The lack of faith in the possibilities of the market is a major failing of Philippine economic policies in the past. If the market had been more vigorously relied upon in the years following independence, instead of the unfortunate policies of exchange and import controls and the pastiche of patch-up solutions for every economic problem that had occurred, it is likely that the Philippine economy would look very different today. There would be greater national progress. The cumulation of massive waste of capital in the economy is similar to having lost a costly war through the partial destruction of the nation's productive capacity.

Much talk continues on our problems in dealing with external institutions, like the IMF, concerning the critical economic adjustment that has to be made. This deserves a few pointed direct comments.

First, the substantive problem that we face today amounts to a large economic crisis. Much of this crisis is of our own making. It is

not that of other external institutions and countries. Their involvement is that they got caught in the web of our problems. The crisis can be traced to certain concrete steps undertaken by the nation's government in responding to challenges. It can also be traced to historical roots, and in this sense the culpability extends to a long line of decisions.

There was lack of trust in market solutions, which would have relieved the burden of government in handling intricate problems and kept the government busy *where it mattered* — providing basic services of public investment in social infrastructure, keeping public health, education, and peace and order. What the government did was to undertake unnecessary expansion in some sectors. The faith in market solutions would have encouraged rather than inhibited the private sector. It would have made the country better developed in industry, agriculture, and commerce than it is today.

Second, the responsibility of the government is to see to it that the nation, including the government's total fiscal programs, lived within its means. This also requires that government entities must be fully accountable for their actions. We must learn to control total spending and to have a very responsible fiscal policy. We must make ministries and government corporations and semi-public monopolies accountable for their activities. Appropriate fiscal restraint has to align with financial and monetary prudence. The problem arises when too much lip service is paid to controlling the excesses of government spending when, as the public has found out in recent years, some sectors of government are allowed their merry way in spending not only on wasteful projects.

Only recently, you might have noticed in the vicinity of the Quezon Memorial Circle in Quezon City that a new, special hospital was hurriedly constructed. This is in spite of the overlay of several government-built hospitals constructed in this area and the fact that the nation is in a deep economic crisis with a hold order on most new government programs. Incidentally, this area was originally the site for a government center until these hospitals preempted the space. This new center is geographically between the heart center and the lung center. This is the kidney center, the newest of the network of expensive, specialized service hospitals. I wonder how much subsidy was allotted by the Budget ministry to this center for 1984.

Even if there were no conditionality attached to the extension of new loans for the economic adjustment program, the government needs to demonstrate sincere restraints in spending especially in cases

where an act can be symbolic and therefore meaningful. The IMF facility and the restructuring of the external debt which has been negotiated can only provide some temporary relief. There is need for sacrifice together with an ultimate strategy that is sound. A great regard for true economy and economic effectiveness would be needed in the years to come. Therefore, there should be no room for wasteful spending.

Nation building has its ups and downs. Temporary setbacks, such as the present crisis, can give severe lessons for us. The pitfalls can be avoided if they are known. Some useful rules may hopefully result which can save us. An optimistic look at the present conditions would be to imagine that we have been dealt a wound that, in time, would teach us an important lesson. After healing, the body can rebuild again, perhaps with greater vigor.



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